



11 o'clock files

Simply AS à la Monetarist School

Aggregate Supply

- The AS shows the *planned* level of domestic output domestic firms are willing to offer at different average price levels per period

Money wage vs. the real wage

- The *money wage* is what's written on your paycheck;
- The *real wage* is what you can buy with your money wage; so the real wage is the purchasing power of your money wage: $W_r = \frac{W_m}{APL}$

Monetarist / New Classical School

- They distinguish between the short run and the long run
- There is thus a short run AS (SRAS) and a long run AS (LRAS)
- In the short run, money wages are assumed fixed
- In the long run, money wages are assumed flexible and that they fully adjust to any changes in the price level

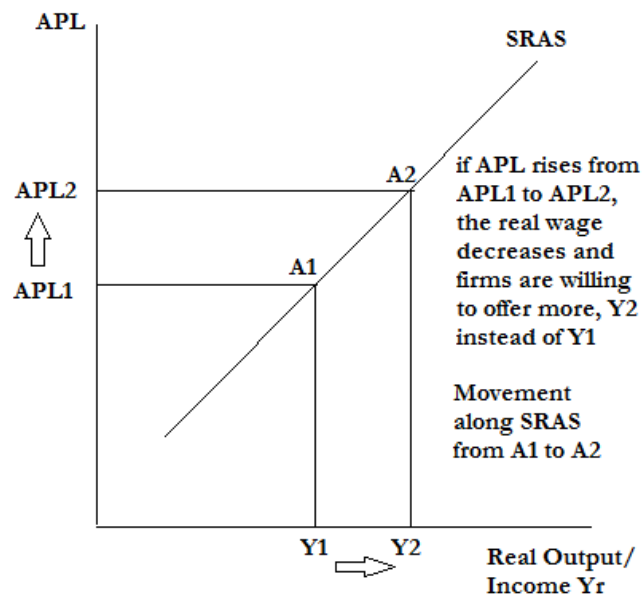
The Monetarist Short Run Aggregate Supply (SRAS)

- Since money wages are assumed fixed → if the average price level changes then the real wage will be affected and thus induce an 'output response' → workers become, in real terms, 'cheaper' or 'pricier' to firms.

Their SRAS is thus upward sloping because:

- if $APL \uparrow$, then the real wage \downarrow → firms will be willing to offer more output
- if $APL \downarrow$, then the real wage \uparrow → so firms will be willing to offer less output

The Monetarist SRAS



The Monetarist Long Run Aggregate Supply (LRAS)

- Monetarists assume that in the long run, money wages are *flexible* and they *fully* adjust to changes in the average price level
- If for example APL \uparrow by, say 2.3% then money wages will also increase by 2.3%
- It follows that the real wage does not change \rightarrow no output response by firms will result

Their LRAS is thus vertical because:

- Thus in the long run, changes in the APL will not affect real output
- In the long run, an economy will produce whatever it can produce given its resources and technology
- The LRAS will thus be vertical at the economy's Potential Output (Y_p)
- Note that at Y_p there is *some* unemployment, the normal or natural unemployment (NRU), which is unavoidable

The Monetarist LRAS

